# REGULATORY AND POLICY DEVELOPMENTS

## ADVISORY COUNCIL APPOINTED

On January 22, 1987, Consumer and Corporate Affairs Minister, Harvie Andre, announced the appointment of an advisory council to be consulted on the appointment of lay members to the Competition Tribunal.

Mr. Andre stated that he believed "this council will ensure that the appointments to the new Tribunal will fully reflect the interests of many groups in Canada."

The members of the council are:

Janice Kerr, Truro, Nova Scotia, Acting President of the Consumers' Association of Canada Foundation;

Cranson Knechtel, Kitchener, Ontario, President and owner of The Knechtel Corp.;

Edward W. Best, Calgary, Alberta, partner at Foster Research (Management and Economic Consultants);

Edward F. Horsey, Q.C., Vancouver, British Columbia, partner in the legal firm of Bull, Housser and Tupper;

Fred Veuger, Vancouver, British Columbia, President and General Manager of CAE Machinery Ltd.;

Gerard E. Docquier, Toronto, Ontario, General Manager and Canadian Director of the United Steelworkers of America; and

Marie Deschamps, Montreal, Quebec, attorney and partner in the legal firm of Byers Casgrain.

The *Canadian Competition Policy Record* understands that the advisory council has had one meeting since its appointment. At that time it met with Madam Justice Barbara Reed, Chairperson of the Competition Tribunal and officials of the Department of Consumer and Corporate Affairs. Mr. Calvin Goldman, Director of Investigation and Research, also briefed the council members on the *Competition Act* and the work of his office. At the time of writing, no appointments of lay members have been made to the Tribunal other than the appointment of Dr. Frank Roseman as previously reported in the *Canadian Competition Policy Record.*

## COMPETITION BUREAU CREATES NEW MERGERS UNIT

Cal Goldman, Director of Investigation and Research, is taking steps to set up a specialized mergers unit within the Bureau of Competition Policy. The unit will play the primary role in handling all merger cases, including prenotification proceedings and merger-related advisory opinions issued under the Director's Compliance Program.

With the exception of the Marketing Practices Branch, the Bureau has been structured along sectoral lines, with branches focusing on Resources, Manufacturing, Services, and Regulated Industries. This arrangement allowed staff to develop detailed knowledge about specific industries and markets within each sector. The reorganization is seen as a reflection of the need for specialized expertise and expeditious handling of merger matters under the new provisions of the *Competition Act.*

Experienced officers from other sections of the Bureau are being assigned to the new unit.

The Bureau has undertaken a complete review of its security arrangements in order to ensure that it is taking all appropriate measures in light of its new role in merger cases. The Bureau, in fact, has not experienced any problems of this type and is noted as being a very "tight" organization. However, there was a recognition that a review may prove of benefit, in particular, to ensure the security of information provided under the new merger prenotification requirements.

According to Mr. Goldman, the changes within the Bureau will assist in ensuring that it continues to fulfill its mandate under the new *Competition Act* in an efficient and effective manner.

## WETSTON DISCUSSES NEW CIVIL REVIEWABLE PRACTICES

By: Lawson A.W. Hunter
Fraser & Beatty, Ottawa

Howard I. Wetston, Deputy Director (Legal) of the Bureau of Competition Policy commented on the Bureau's enforcement of non-criminal trade practices in an address to the Ontario Branch of the Canadian Bar Association of February 5, 1987.

Mr. Wetston reviewed a number of civil reviewable matters under the legislation and spent considerable time addressing the new provisions relating to abuse of dominant position. Certain of Mr. Wetston's comments are important as to the Bureau's enforcement intentions under the new legislation.

### Class or Species of Business

Under the abuse of dominant position provisions in the legislation, a firm will be found to be in a dominant position if it substantially or completely controls a "class or species of business". However, before an order can be made against such a firm, it must be found to be engaging in a practice of anti-competitive acts having the effect of substantially lessening competition.

Mr. Wetston commented on the argument made in some quarters that the term "class or species of business" does not mean the same thing as "market." After referring to the discussion of the meaning of "class or species of business" in the *Eddy Match* case, wherein a rather narrow definition was given to the term, Mr. Wetston seemed to give short shrift to the notion that "class or species of business" would be narrower than the definition of the relevant market.

Although the position seems contrary to the decision in the *Eddy Match*, Mr. Wetston stated that "[I]n all likelihood the usual starting point for determining whether a firm substantially or completely controls a class or species of business will be its share of the relevant market."

He also stated that "defining the relevant market is necessary in order to determine whether the conduct of the dominant firm lessens competition substantially."

Although it is undoubtedly true that the market will have to be defined in order to allow a finding of lessening of competition, it is arguable that "class or species of business" has a somewhat narrower focus. Nevertheless, Mr. Wetston's remarks indicate that the present Bureau policy is to equate "class or species of business" with "market."

### Substantial Lessening of Competition

Mr. Wetston also commented on the meaning of "substantial lessening of competition." He stated that the starting point for analysis of this question will be market shares of the firm or firms involved. He said:

> This follows from the basic economic premise that only firms enjoying a significant market share are able to exert dominance in the market. From there,

the analysis requires an examination of the nature of the practice and a consideration of the basic features which determine the nature and extent of the competition in the market. Relevant conduct factors may include imposing terms and conditions of supply that are inconsistent with a competitive market, excessive pricing and selective price cutting to discipline competitors among others. Structural considerations essentially require an examination of other sources of competition such as substitute products, extent of foreign competition, rates of entry and exit and whether potential entrants are located in the domestic market or offshore. Industry performance factors that may have a bearing on the determination of whether a practice "substantially" lessens competition could include the extent of technological change in the relevant market, rates of return and increasing concentration in the face of increasing demand or constant technology. As well, certain institutional factors such as the regulation of entry or licensing requirements may also be relevant to this test.

## Superior Competitive Performance

In another part of his address, Mr. Wetston dealt with the meaning of "superior competitive performance" as it appears in subsection 51(4) of the *Act*. He stated:

> If competitors leave the market or lose market share because a competitor is more efficient than its rivals or more effective in meeting consumer needs, the lessening of competition does not result from an abuse of market power, but rather it is a natural consequence of the competitive process. This factor is therefore included in the *Act* to ensure that efficiency, innovation and like considerations are given proper weight by the Tribunal in its assessment of the trade practices of a dominant firm or firms.
>
> The indicia which may be included in considering whether the practice results from superior competitive performance may include economies of scale, scope or location, innovation and research, and distribution and marketing methods. As well, the origin of the firm's dominant market position could also play an important part in determining whether the practice results from superior competitive performance or the abuse of market power. In this respect, the Tribunal may consider whether the firm acquired its position in the market by way of natural growth stemming from superior skill, foresight or industry, or by way of acquisition, financial power or below cost pricing.

Mr. Wetston further indicated that although the onus will lie with respondents to raise superior competitive performance issues with the Tribunal, the Director will take such factors into account in the investigation stage of abuse of dominant position matters.

## New Enforcement Approach

Mr. Wetston raised in his address certain new enforcement approaches being considered by the Director. Among other issues, he stated that the Bureau will be issuing bulletins regarding the enforcement and interpretation of the *Act*. As well, the Bureau is developing criteria for accepting negotiated settlements and using information visits and letters as alternatives to judicial or tribunal adjudication.

Mr. Wetston also indicated that the Bureau will continue to rely on the voluntary program of compliance to resolve possible legal difficulties in advance.

In discussing the use of information visits and letters, Mr. Wetston made the following statement:

> This technique, however, would only be used to deal with relatively minor matters when a complaint is initially logged with the Bureau. It is now primarily used by the Marketing Practices Branch to deal with misleading advertising and deceptive marketing practices complaints. When a complaint is received, depending on the circumstances, the investigator may simply contact the company involved, explain the applicable law, and how it applies in the circumstances. Receipt of a second complaint in a similar fact situation would lead to a more thorough investigation.

In discussing this proposal, Mr. Wetston indicated that matters such as refusal to deal, consignment selling, and exclusive dealing, tied selling and market restriction would appear to be areas where information visits and letters may be particularly appropriate. He commented that the abuse of dominant position provisions may be less susceptible to such informal methods. He made this comment, because under the abuse of dominant position provisions, the Director can

seek a remedial order up to three years after the practice has ceased. In addition, Mr. Wetston expressed the view that since the remedial orders under the abuse provisions usually involve an element of anti-competitive purpose or design, the matters may require a more formal resolution than other civil reviewable practices set out in the legislation.

The Bureau is obviously grappling with how to efficiently administer the new, as well as old, provisions of the legislation, especially in a time of budgetary restraint in Ottawa. Businesses should be particularly attuned to the changing administrative practices and procedures as they evolve under the new legislation.

## BROADCASTING IN CANADA MORE OUTLETS, FEWER VOICES

By: Andrée Wylie, Smith, Lyons Torrence, Stevenson & Mayer, Ottawa

Within one month, the Canadian Radio-television and Telecommunications Commission issued three decisions granting licences for major new television stations and authorizing the transfer of control of major existing television stations to parties already operating significant broadcasting undertakings in Canada. In each case, the Commission weighed the potential benefits that would flow to the communities concerned and to the Canadian broadcasting system as a whole from approval against the potential disadvantages of increased concentration of ownership in the broadcasting industry. It found each transaction to be in the public interest.

### New Brunswick Broadcasting

On January 22, 1987, the Commission approved applications by New Brunswick Broadcasting Co. Limited for licences to establish new English-language television stations at Halifax, Nova Scotia, and Saint John, New Brunswick, with rebroadcasters in Fredericton and Moncton, New Brunswick. The stations will add independent, over-the-air, television service in these communities.

New Brunswick Broadcasting is ultimately owned and controlled by members of the K.C. Irving family. It is the licensee of CHSJ-TV, the CBC-affiliated television station in Saint John, with rebroadcasters throughout the province, and of an AM radio station in Saint John. The Irving family also controls New Brunswick's four English-language daily newspapers, two in Saint John, one in Moncton and one in Fredericton.

As recently as 1983, New Brunswick Broadcasting challenged unsuccessfully in the Federal Court of Appeal a decision of the CRTC renewing CHSJ-TV's licence for less than three years and putting New Brunswick Broadcasting on notice that it had to rearrange its affairs to comply with the provisions of a Cabinet Direction on media cross-ownership. The Cabinet Direction issued in 1982, pursuant to the *Broadcasting Act,* made the proprietor of a daily newspaper distributed in a particular market area ineligible to hold a broadcasting licence to provide service in that market area. In 1985, before further appeal was pursued, the Mulroney Cabinet repealed the Direction and, shortly after, New Brunswick Broadcasting applied for new licences in the Maritimes.

Two of the nine Commissioners dissented in the 1987 decision granting New Brunswick Broadcasting further television licences, in part because of concerns with respect to media concentration, and, in light of the realities of the markets involved, the permanently lost opportunity for a new television voice in these markets. However, the majority appeared to have little difficulty in approving the proposal. They stressed that no other application was submitted in response to a call for applications, that approval would result not only in an alternative locally-oriented television service in New Brunswick but also in full CBC English-language television service finally being provided in New Brunswick by CHSJ-TV at no cost to the CBC in a time of budgetary constraints. New Brunswick is currently the only province in which the CBC does not own or operate English-language television broadcasting facilities.

The Commission also emphasized that New Brunswick Broadcasting is healthy financially and has over thirty years of experience in television broadcasting in New Brunswick. Other benefits outlined included New Brunswick Broadcasting's plans to extend its new services throughout the maritime provinces at the earliest possible date and the possibility of adding the new service to the package of services distributed by CANCOM via satellite to remote and underserved areas of Canada.

The Commission expressed the view that there would continue to be available to the communities concerned the effective degree of diversity of ownership and of programming sources required to ensure that the objectives of the *Broadcasting Act* are met. Similarly, there would continue to be available, in the Commission's view, an overall diversity of information, opinion and broadcasting sources in the region concerned sufficient to provide its communities with differing points of view on matters of public concern.

Approval was found to be in the public interest despite the apparent lack of safeguards proposed by the applicant to alleviate the concerns raised with respect to media concentration. In fact, many of the operations of the new station will be integrated with CHSJ-TV. The dissenting Commissioners pointed out that approximately nine hours per week of news and community affairs oriented to New Brunswick to be part of the Saint John programming schedule will be produced at New Brunswick Broadcasting's studios in Saint John and that the local input of thirteen hours on CHSJ-TV will also continue to be provided by New Brunswick Broadcasting rather than by CBC staff.

The dissenting Commissioners concluded that the addition of thirty hours of CBC network programming in New Brunswick resulting from the approval came at too high a price.

**Videotron/Télé-Métropole**

On January 27, 1987, the Commission approved applications for authority to transfer to Le Groupe Vidéotron Ltée of Montreal, for a sum of $134.1 million, effective control of Télé-Métropole Inc. Télé-Métropole is the owner of CFTM-TV in Montreal and of the TVA affiliate in Chicoutimi. CFTM-TV is the flagship station of the TVA network. Télé-Métropole also has corporate ties with five of the remaining eight TVA affiliates in major markets of the province of Quebec. Vidéotron is the second largest cable company in Canada, the largest in the province of Quebec and the second largest in Alberta. It provides cable service to 55% of the cable subscribers in the province of Quebec.

Ten months earlier, the Commission had denied applications for authority to transfer control of Télé-Métropole to Power Corporation of Montreal for some $30 million less. The Commission had found that the prospective transferee had not met the threshold test in applications for transfer of ownership or effective control: whether significant and unequivocal benefits would result from the transaction for the communities concerned and for the Canadian broadcasting system as a whole.

Some opposing interveners felt that the Vidéotron proposal raised issues related to concentration and media cross-ownership. They expressed particular concern that Vidéotron's cable and television undertakings would become overly integrated at the expense of the public interest, in particular with regard to the opportunity to exchange information obtained from cable subscribers with CFTM-TV and to the potential use of CFTM-TV by Vidéotron to advertise the non-programming services it offers on its cable systems. The adequacy of the control measures proposed by Vidéotron to ensure equitable access to its cable undertakings and to respond to complaints was also raised.

**CanWest/Western Approaches**

On February 13, 1987, the Commission approved an application for authority to transfer effective control of Western Approaches Limited to CanWest Pacific Television Inc., a subsidiary of CanWest Broadcasting Ltd. Western is the licensee of CKVU-TV, the independent

television in Vancouver. Control of Western was held by three of CKVU-TV's founding shareholders. CanWest Broadcasting is ultimately owned by Israel Asper of Winnipeg. It is the licensee of CKND-TV, the independent television station in Winnipeg. CanWest was also licensed recently to provide independent television service in Regina and Saskatoon, Saskatchewan. Mr. Asper also holds, indirectly, a 60.75% equity position in Global Communications Limited which operates Global Television's seven transmitters in southern Ontario.

The Commission determined that CanWest had met the significant and unequivocal benefits test. It further expressed the view that the transaction does not present the characteristics of concentration that would be of concern in that the transfer would not decrease the diversity of media voices in the market place.

The principal benefit yielded in the public interest by the transfer, in the Commission's view, appeared to be that it would put an end to the acrimonious disputes and expensive and disruptive litigation between some shareholders and CanWest which have plagued Western since 1979. CKVU-TV's board and management would thus be able to focus on meeting the station's objectives and commitments. Ironically, the Commission expressed concern recently that disagreements between Mr. Asper and other shareholders of Global could have a detrimental impact on that licensee's performance of its obligations as a broadcaster.

The benefits considered to flow from the Western-CanWest transaction also included the increased clout that would accrue to CanWest and its related broadcasting undertakings from a broadening of its base of operations. It would lift CanWest from the smaller to the major leagues of Canadian television, giving it greater leverage on other stations in Canada to co-produce with CanWest stations. It would enhance the distribution and exhibition of programming produced by CKVU-TV. It would ensure increased cooperative ventures for quality, first class Canadian productions through a consolidation of strength and talent. It would also facilitate program exchanges and co-scheduling with other CanWest-related independent television stations, due to the fact that such stations would not be dealing at arm's length and engaging in protracted negotiations.

## Comment

There is little doubt that Canada is witnessing a period of concentration in broadcasting. Whereas in the first 15 years after the advent of the *Broadcasting Act* the Commission was busy issuing licences to new entrants in the industry, it is now overseeing the consolidation of broadcasting power in fewer hands. The Commission has recently intensified its expectations that broadcasters produce Canadian programming capable of vying with American fare for audiences in prime time. Its recent licensing decisions, including the ones noted here, suggest that it believes that only the strength that comes from size, financial stability and the pooling of marketing, managerial and creative resources often dependent on common ownership of a number of broadcasting outlets will make the achievement of this goal possible. The onus appears to have shifted to those concerned about media concentration to demonstrate that its potential disadvantages outweigh the potential benefits to be gained from it.

In December 1986, the Commission heard five competing applicants for a licence to provide independent television service in Ottawa. Only one applicant was not part of an established television broadcaster with multiple outlets. On March 2, 1987 the Commission approved the application filed by Baton Broadcasting, licensee of CFTO-TV, the Toronto flagship station of the CTV network to whom transfer of control of all the existing private stations in Saskatchewan except CJFB-TV in Swift Current was approved in 1986. The Commission concluded that, in that case, due to the many advantages that will accrue from the creation of a large pool of resources strong enough to compete with foreign programming and to produce Canadian programming of competitive quality, the extensive broadcast holdings of Baton should not be a determining factor.

## COMPETITION IN THE PROVISION OF TELEPHONE SERVICE

In 1985, the Canadian Radio-television and Telecommunications Commission relaxed some of the restrictions against resale and sharing of telecommunications services and facilities leased from federally regulated telephone companies in order to allow the introduction of a more competitive market for such services.

Resale refers to the subsequent sale or lease, on a commercial basis, by a customer of a telephone company, of telecommunications services leased from the telephone company. Sharing refers to the use by two or more persons, without resale, of telecommunications services leased from a telephone company.

Resale and sharing of services to provide all services other than long distance and Wide Area Telephone Services and primary exchange voice services would henceforth be permitted. Sharing to provide primary exchange voice services and the sharing of long distance service to provide long distance service would also be allowed. Carriers were required to file tariff revisions, including the restrictions to be imposed, to implement the Commission's decision. Further comments were invited on the issue of resale to provide primary exchange voice services or basic local service.

A decision providing further relaxation by allowing resale to provide primary exchange voice services other than Pay Telephone Service and resale of long distance service to provide long distance service was issued by the Commission on February 12, 1987 at the same time as a decision setting out the tariff revisions necessary to implement the new resale and sharing environment. Revised tariffs were to be filed by February 27, 1987. Implementation of the new regime is expected this Spring.

Telephone companies and other interested parties proposed differing definitions and other restrictions as part of an underlying framework to be reflected in the carriers' tariffs for the orderly introduction of resale and sharing in the non-long distance/WATS market. Business users argued that the limitations proposed by the telephone companies were so restrictive as to jeopardize in practice the development of a competitive resale market and all but eliminate a number of attractive resale and sharing opportunities. Such users were particularly opposed to the requirement that each resold circuit to provide interexchange voice services be dedicated to the private use of a particular customer of a reseller.

The restrictions endorsed by the Commission reflect primarily a desire to foreclose the resale and sharing of telephone facilities and services to provide long distance and WATS equivalents, in order to preclude any erosion of the contributions to the carriers' revenues from such services. They also reflect a desire by the Commission to adopt restrictions which are not susceptible to varying interpretations. The Commission was anxious to make more competition possible without the need for costly, time-consuming regulatory intervention to ascertain or settle disputes, on an *ad hoc* basis, whether the services provided through resale and sharing comply with the tariffs with respect to the prohibition against resale and sharing of non-long distance services to provide long distance/WATS services.

The new environment can be reviewed under three major headings: resale and sharing to provide data communications services, resale and sharing to provide interexchange voice services, and resale and sharing to provide primary exchange voice services.

The untrammelled resale and sharing of data communications services that have access to computers will be permitted. The Commission rejected the carriers' suggestion that resellers and sharers seek CRTC orders exempting them from the restrictions applicable to interconnected voice services before providing interconnected data services. The Commission agreed that it would be a costly and time-consuming exercise which is not necessary to prevent the provision of long distance and WATS equivalents.

The restrictions applicable to resale and sharing of services other than long distance and WATS to provide basic interexchange voice services were considered under two categories, services that provide access or connection to the public switched network (interconnected) and services that do not (non-interconnected). A number of restrictions were imposed for the provision of interconnected interexchange voice services. The principal one is the requirement that each circuit leased from the telephone company be dedicated to the user thereof and that each company-provided circuit be terminated at equipment dedicated to the user. A user is defined as "a sharing group or a customer of a reseller using the company's telecommunications services for the user's private communication needs." Where resale is involved, a "user" is thus the customer of a reseller while in a sharing agreement, a "user" is a sharing group. Resellers are to be the telephone company's customers and are to be responsible for all amounts incurred for the services provided to them by the company. A sharing group is to obtain services directly from the telephone company. It is the telephone company's customer that must enter into and file with the company a sharing agreement providing for the joint and several liability of each member of the group for all charges payable to the Company.

The resale of leased private lines on a circuit-by-circuit basis will thus be possible but resale of such lines on a call-by-call basis will not. In other words, resellers will be able to resell lines leased by them on a bulk basis one by one but will not be able to resell the use of one line to a number of users. However, a sharing group will be able to use the private lines it leased from the telephone company as if it were a single company, allocating their use on a call-by-call basis. By sharing private lines and combining traffic, small businesses may thus achieve the economies of scale previously available only to firms with high traffic volumes.

Resale and sharing to provide primary exchange voice services, including residential and business services, will allow the providers of shared tenant facilities to install a single group of trunk lines rather than the several small ones previously required to provide services to each tenant. Improved cost-effectiveness will increase the opportunities for shared use of facilities and services by tenants of large apartment and office buildings and will render more accessible to small users the more sophisticated technologies and specialized telephone company services available to large users. Underlying carrier services and facilities will be provided to resellers under the terms and conditions of the tariffs, including tariff rates. Resellers will be responsible to the telephone company for the amount due for the services they lease and resell, including any long distance charges incurred by the resellers' customers and billed to the resellers. Resellers will also be responsible for the quality of service provided to their customers. In order to ensure that choice of service offerings, a primary benefit of resale, remains available to the end user, direct access to telephone company services under reasonable terms and conditions will be guaranteed to any tenant not wishing to obtain services from a reseller.

The new rules governing resale and sharing of telecommunications services are expected to allow economies for large businesses and greater efficiency and choice for the tenants of apartment and office buildings. They are unlikely to open a floodgate of competition with the telephone companies due to the level of restrictions maintained and, of course, to the continued prohibition against the resale of long distance service. Small businesses who have less need to rent dedicated services may not reap the benefits that they could have were it not for the rule limiting resale and sharing of private services leased from a telephone company to services dedicated to the use of one specific user, a rule which tends to eliminate many of the economies of scale required to make resale a viable proposition.

## FEDERAL GOVERNMENT PRIVATIZES TELEGLOBE CANADA-- COMPANY BROUGHT UNDER REGULATORY CONTROL

By: Eric A. Milligan
Milligan and Company Inc., Ottawa

On February 11, 1987, Barbara McDougall, federal Minister of State for Privatization and Regulatory Affairs, announced the government's intention to sell Teleglobe Canada to Memotec Data Inc. of Montreal. Teleglobe operates Canada's overseas telephone facilities (cable and satellite services).

Total proceeds to the government from the sale were pegged at $608.3 million. According to Ms. McDougall, the Memotec offer was the highest bid received in the competitive process which saw offers from the Caisse de dépot et placement du Québec, Spar Aerospace and Canadian Telecommunications companies; First City Financial Corporation; Gordon Investment Corporation; Inter-City Gas Corporation; and Power Corporation of Canada.

Before bids could be formally solicited, it was necessary for the government to make policy decisions concerning the extent to which the firm's monopoly over Canada/overseas telecommunications services was to be preserved. Decisions were also required concerning the method of regulatory control necessary, limitations on ownership by domestic telephone companies, limitations on foreign ownership, specification of a rate-base, determination of the initial debt-equity ratio, and levels of initial rates.

The decisions on these matters were set out in a "Statement of Telecommunications Policy Respecting Teleglobe Canada" released by the Department of Communications in November 1986. It is clear that the government paid careful attention to the competitive implications of the sale and attempted to strike a balance among a variety of competing objectives. McDougall's job was to obtain the best possible purchase price, ensure the long-run viability and profitability of the company, protect the interests of the existing employees, allow consumers the benefit of lower prices through competition, maintain the government's ability to ensure the achievement of national telecommunications policy objectives, and avoid the imposition of unnecessarily restrictive regulatory controls.

The government decided that it was in Canada's national interest that telecommunications services between locations in Canada and from Canada to other locations, to the greatest extent feasible, be provided over Canadian-owned and controlled facilities. Consequently, the sale proceeded on the basis that, for a period of at least five years, Teleglobe will remain the sole authorized Canadian operator of facilities to provide Canada/overseas telecommunications services. The policy statement indicated, however, that the continuation of this policy will depend upon Teleglobe's performance in providing "efficient, high-quality telecommunications services to Canadians".

The policy also requires that effective control of the company remain in Canadian hands at all times. Domestic telephone companies cannot acquire more than 40% of the company and, within that limitation, may not exercise effective control.

The Canadian Radio-television and Telecommunications Commission (CRTC) has been designated as Teleglobe's regulator pursuant to the *Railway Act*. Regulatory control by the CRTC includes rate approval, and approval of transfers of effective control or disposition of the substantive assets of the business. The CRTC is authorized to forebear from the regulation of competitive telecommunications and non-telecommunications activities of Teleglobe. The company is exempted from the requirement to obtain regulatory approval for agreements with foreign carriers and foreign administrations, although all such contracts and agreements must be filed with the CRTC.

As part of the divestiture, the government decided that Teleglobe's rates should be reduced. The weighted average collection rates for overseas telephone calls is being reduced by 13.5% and charges for telex services will drop 10% effective January 1, 1988. The savings from the rate reductions are to be passed on fully to end-users.

The policy specified that the CRTC would accept as the allowed rate of return on common equity on average over the period January 1, 1988, to December 31, 1991, the rate defined by "the weighted average mid-point of the allowed return on common equity of Bell Canada and BC Tel, and that average plus 2%". The weights are to be based on operating revenues. The CRTC will accept rates filed that will allow Teleglobe to achieve a return falling within the range defined by this formula.

In order to allow rate-of-return regulation it was necessary for the government to establish Teleglobe's opening capital structure. The initial base has the net fixed assets of the company deemed at 140% of net historical book value as reflected in Teleglobe's balance sheet at the time of sale. The initial long-term debt/equity ratio has been set at 45/55.

Finally, the government maintained its authority under S. 64(1) of the *National Transportation Act*, to vary or rescind any order or decision of the CRTC. The policy explicitly stated that these powers will be used to ensure that regulatory decisions affecting the mandate or responsibilities of the Teleglobe are consistent with government policy.

Given the significance of the policy decisions and the complexity of the trade-offs, it is not surprising that it took a while for the Federal government to formulate the regulatory policy for Teleglobe, but the time appears to have been well-spent. The policy has met with general acceptance by most of the concerned interests, the bidding process was carried out without significant problem, and, judging by the terms of the sale to Memotec, the government has achieved everything that it was seeking. Bill C-38, which authorized the re-organization and divestiture of Teleglobe and set out the basic regulatory groundrules, moved steadily through the various stages of Parliamentary approval after its introduction in January. The legislation was approved by Parliament in time to complete the transaction before March 31, 1987, which marked the end of the government's fiscal year.

## PRIVATIZATION MARCHES ON

Slowly, but steadily, the Federal government is reviewing its holdings of commercial enterprises and is returning some to the private sector. Barbara McDougall, the minister responsible for privatization, describes the approach as "pragmatic" and "businesslike". The track record to date is as follows:

July, 1985--the *Northern Transportation Company Ltd.* was sold to a consortium of the Inuvialuit Development Corporation and Nunasi Corporation. Price: $27 million.

August, 1985--in a public issue, the Government offered for sale 23 million shares of the *Canada Development Corporation* priced at $11.50 each. Approximately 21.8 million of the shares were sold with net proceeds of $246 million. The sale was completed in September, 1986.

December, 1985--the sale of *Canadian Arsenals Ltd.* to the SNC Group was announced. Price: $92.2 million.

January, 1986--*de Havilland Aircraft* was sold to the Boeing Company. Price: $90 million cash and a note for a further $65 million which will be forgiven if Boeing purchases new products worth $325 million from Canadian-based suppliers.

April, 1986--all issued shares of *Pêcheries Canada Inc.* were sold to La co-opérative agro-alimentaire Purdel. Price: $5 million, subject to final adjustments.

October, 1986--the Government's 18% equity interest in *Nanisivik Mines Ltd.* was sold to Mineral Resources International Ltd. Price: $6 million.

December, 1986--*Canadair Limited* was sold to Bombardier Inc. Price: $120 million plus approx. $173 million over time in Challenger royalties.

December, 1986--Canadian National sold *CN Route*, its express and trucking operation division, to Route Canada Holdings Inc. Price: $29 million.

February, 1987--*Teleglobe Canada* was sold to Memotec Data Inc. Total proceeds: $608.3 million.

## TRANSPORT DEREGULATION BILLS CLEAR SECOND READING

After lengthy debate, the federal transport deregulation legislation, Bills C-18 *(National Transportation Act)* and C-19 *(Motor Vehicle Transport Act)*, received Second Reading in the House of Commons and are now being considered by the Standing House Committee on Transport. The new legislation will substantially deregulate the air and trucking modes and introduce greater competition in the rail sector.

The debate had been opened by John Crosbie, Minister of Transport, on December 19, 1986, immediately prior to Parliament's Christmas recess. It resumed exactly one month later on January 19, 1987. André Ouellet, transport critic for the Official Opposition, took issue with both the content of the legislation and the manner in which it was being handled by the government. He noted that while transport deregulation had been initiated by the previous (Liberal) government, their approach was more incremental, aimed at regulatory flexibility. Ouellet charged, "by deciding to change everything at the same time, the present government has raised a veritable wave of panic in many areas of the transportation industry..."

Air safety, services for the handicapped, increasing concentration in the air sector, the role of transport in regional expansion, and the protection of jobs in the transport industry were raised as specific concerns by Mr. Ouellet and by other opposition party speakers who followed in the debate.

The lead-off speaker for the NDP was Les Benjamin, the party's transport critic and a long-time member of the House of Commons Transport Committee. Mr. Benjamin's criticisms of the legislation went right to the heart of the government's policy for greater competition and less regulatory control. He charged that:

> [the Bill ignores] the economic imperative for the provision of equitable transportation services, rates and fares for all of Canada...it will return this country to the situation of many decades ago; travellers, shippers and receivers will again be discriminated against because of where they happen to live, or where they happen to manufacture, grow, produce or process their products.

In addition to citing safety concerns for air, rail and trucking modes, Mr. Benjamin asserted that the legislation would provide access and advantage for U.S. railway and trucking companies in Canada, benefits that will not be reciprocated for Canadian firms operating in the U.S.

After lengthy debate and some procedural attempts by the Opposition to "derail" the legislation, debate on Bill C-18 was finally brought to a close by the exhausted MPs at 3:00 a.m. on February 4, 1987. The motion for Second Reading was carried by the government majority later that day and the Bill was referred to the House of Commons Standing Committee on Transport for study.

Second Reading debate on Bill C-19, the *Motor Vehicle Transport Act,* 1986, began on February 5, 1987. The legislation received Second Reading on February 11 and was likewise referred to the Standing Committee on Transport.

Sending the legislation to the Transport Committee for detailed review represented a

departure from the normal procedures of the House of Commons. All-party agreement was necessary to waive the requirements of the new Standing Orders which specify that bills are to be referred to special "legislative committees" that are struck when legislation clears Second Reading. Given the close involvement of the Standing Committee in the development of the Freedom to Move policy, and the knowledge that the Committee's members have of the transport sector, the decision to make an exception for this legislation made good sense.

The Minister of Transport, Mr. Crosbie, and his officials were the first witnesses to appear before the Transport Committee on February 17, 1987. In his prepared statement, Mr. Crosbie reiterated the government's strong commitment to the underlying principles of the legislation and reviewed the major benefits to the Canadian economy expected as a result of the reforms. Mr. Crosbie also addressed several of the criticisms that had been raised during the Second Reading debate, including levels of service for remote communities, safety, viability of the railways, and competition from U.S. truckers.

The Minister indicated an openness to consider amendments that might be suggested by the Committee on the basis of its hearings and study of the legislation. He stated:

> Undoubtedly you are going to find provisions in the suggested legislation that require clarification. You may discover there have to be adjustment to avoid unintended effects.... If you think that anyone who appears before the committee has seriously made a point that needs to be dealt with, then we will certainly consider your position, and if amendments are needed we will assist in drafting any amendments that might be needed. This is too important to be stubborn or headstrong about it...

Since Mr. Crosbie's appearance, the Transport Committee has heard from a broad cross-section of carriers and shippers. It has conducted hearings in the West as well as in the Atlantic provinces and Quebec.

It is evident that the government is according the transport legislation a high priority in the Parliamentary timetable. Given the significance of the proposals and the sheer bulk of the documentation presented to MPs, its progress through the House has been extremely good. Unless some major catastrophe occurs during the remainder of Committee Stage, in Third Reading, or in the Senate, the legislation (probably with some adjustments by the Transport Committee) appears to be headed for passage before Parliament rises for its summer recess.

## THE MERITS OF ESTABLISHING A NATIONAL AGENCY FOR POTATOES -AN OPINION BY THE DIRECTOR OF INVESTIGATION AND RESEARCH

Recently, the Director of Investigation and Research submitted to the National Farm Products Marketing Council an opinion as to the merits of establishing a national marketing agency for potatoes.

The Director's recommendations on the potato marketing agency were as follows:

- the establishment of a national potato marketing agency would be costly to implement and administer;
- it would have adverse affects on the potato industry with respect to prices, performance, efficiency and equity;
- consideration be given to implementing a tripartite stabilization program that would address the income instability of potato producers.

Instead of creating an agency to improve the marketing and price efficiency of the potato industry, it was the Director's recommendation that a marketing scheme, involving the participation of both the potato industry and government representatives, be established to aid market development and pricing.

## REVIEW OF THE FEDERAL POLICY PAPER ON THE REGULATION OF FINANCIAL INSTITUTIONS

By: John Evans
Evans and Associates, Ottawa

### Introduction

The last issue of the *Canadian Competition Policy Record* contained a review of the contents and recommendations of the Report of the Estey Commission into the failures of the Canadian Commercial Bank and the Northland Bank. The government has now released a major policy paper on the regulation of federal financial institutions. This paper builds on the framework proposed in the "Green Paper" of April, 1985, and responds to the reports and recommendations of various Commissions and Parliamentary Committees. It also reflects the concerns raised by a multitude of private sector parties.

The policy paper was released by the Minister of State for Finance on December 18, 1986. It is a revolutionary document when viewed in an historical context. Canadian law has traditionally attempted to maintain strict separation between the four primary sectors of the financial services industry: banking, trust, insurance and securities.

The new policy, coupled with the actions taken recently by the government of Ontario, effectively eliminates these distinctions. In essence, firms in each of the four sectors are now free to engage in any and all aspects of financial service. While at times specific types of service must be provided through subsidiaries for administrative and supervisory convenience, the fact is that the artificial barriers separating the various market sectors have been eliminated.

The effects of these proposals will undoubtedly be to increase the extent and intensity of competition among the various institutions and accelerate the trend towards fewer and larger institutions. Branch networks can now be used more intensively, and we should expect to see fewer retail outlets.

Smaller institutions will likely be relegated to serving particular niches in the market. Their growth will tend to be retarded due to both the high costs associated with establishing wide scale retail operations, and the restrictions which have been placed on infusions of capital from outside the financial sector. As a result, the marketplace will tend to be characterized by a smaller number of very large, well capitalized institutions, with an also smaller number of niche players.

### The Policy Elements

The federal policy contains four key policy elements: modified and enhanced institutional powers, restrictions on institutional ownership, a strengthened regulatory structure, and an improved supervisory system. These will be dealt with in order in the following sections of the paper.

#### Institutional Powers

The government is proposing to greatly expand the direct powers of all federally regulated financial institutions, and, through the provision for the ownership of subsidiaries, to effectively remove any remaining operational restrictions.

Trust, loan and insurance companies will be granted full consumer lending powers, and will have full commercial lending powers subject to supervisory approval and a minimum of $25 million in capital. Companies not meeting the $25 million requirement will be restricted to having no more than 5% of their assets in commercial loans or commercial loan equivalents.

The definition of commercial loans will be very broad and include virtually all means of advancing funds, credit or guarantee of funds to

business. However, it will not include: securities issued under prospectus, securities issued in private placements, or commercial paper, with broad distribution, or corporate mortgage loans undertaken in accordance with existing rules.

All federally regulated financial institutions will be allowed to directly offer investment advice and portfolio management services. Banks and insurance companies will be given some direct fiduciary powers, but will only be allowed to provide full estate, trust and agency services through a trust company subsidiary. All institutions will have full networking capabilities (the ability to offer the products and services of affiliated financial institutions through a common distribution system) with the sole exception of the retailing of insurance.

The current "legal for life" investment rules for non-bank financial institutions and pension funds will be replaced with a new regime based on the concept of a "prudent portfolio". This will allow greater portfolio diversity and improve the matching of assets and liabilities.

The requirement that chartered banks hold non-interest bearing reserves with the Bank of Canada will be phased out starting in 1990.

Legislation governing the Canadian Co-operative Credit Society will be amended in line with the changes proposed for federally regulated financial institutions.

## Ownership

The federal government considered a wide range of possible ownership scenarios. These ranged from no ownership restrictions, as was proposed in the 1985 "Green Paper", to the imposition of a 10% ownership limit as now applies to the large chartered banks. Ultimately, the government decided on a compromise position which sharply restricts the ownership of financial institutions by non-financial entities, restricts ownership of larger financial institutions by any investor or group of related investors, and effectively imposes the 10% ownership rule, albeit phased in over time, on all ownership positions in federal financial institutions taken subsequent to December 18, 1986.

There are still a significant number of specifics relating to the exact nature and application of the ownership rules which are unavailable. The draft legislation on this area is not expected before mid-June. However, with this in mind, the essence of the government proposals are outlined below.

There will continue to be separation of institutions for supervisory purposes. However, common ownership, subject to the general ownership limitations described below, will be allowed for banks, trust and loans, insurance companies and investment dealers. This will allow one-stop shopping through a common distribution system.

Organization of a financial services operation may be either through a Financial Holding Company (FHC) or through direct ownership of subsidiaries by a particular regulated financial institution. The FHC option will also become available to banks. Percentage ownership limitations (outlined below) may be met either at the subsidiary level or at the holding company level. That is, an FHC can be "closely-held" so long as its ownership of subsidiaries falls within the ownership guidelines, or the subsidiaries themselves may be "closely-held" if the ownership of the FHC falls within the ownership guidelines. However, in the FHC case, the capital of all of the related financial institutions will be aggregated for purposes of determining the point at which the ownership rules take effect. These are very important matters and will have to be examined carefully when the legislation is finally tabled.

Large institutions will generally not be allowed to acquire other large institutions (except in the case of investment dealers). Expansion into new areas by most institutions will thus have to be through creation of new subsidiaries. Since

only the large institutions have the capital necessary to create well financed subsidiaries, it may be concluded that smaller firms will be relegated to niche operations.

The Minister of Finance will retain the power to approve all mergers and acquisitions. This power is found in the updated versions of Bills C-8 and C-9.

As per the Ontario rules, all federally regulated domestic financial institutions will be allowed to own 100% of an investment dealer as of July 1, 1987. Foreign federally regulated institutions will be allowed to own 50% as of July 1, 1987 and 100% as of July 1, 1988. An important point here is that this restriction on foreign investors effectively precludes such firms from establishing wholly-owned "de novo" securities operations until July 1, 1988. As such, domestic firms will have a significant head start on their foreign competitors in this area unless the foreign firms decide to enter into an agreement to acquire an existing firm by way of a 50% purchase with an associated option to purchase the remainder after one year. Such an arrangement would probably be coupled with a "management agreement" allowing the foreign firm to effectively control the securities dealer from day one.

To avoid double counting of capital, any investment by a financial institution in another financial institution, which exceeds 10% of the other financial institution's equity, will be deducted from the capital of the investing company in calculating the capital requirements of that investing company for supervisory purposes.

Where insurance companies wish to acquire subsidiaries, supervisory procedures will be established to protect the rights of participating policyholders.

Foreign ownership rules (e.g., the 10/25% ownership rules) will continue to be applicable to the ownership of federally regulated financial institutions by non-residents. Expansion into new areas of financial services by non-resident controlled firms will thus continue to be restricted to the formation of new subsidiaries or the acquisition of existing foreign owned firms (except in the case of securities dealers as noted above).

The basic ownership rules take the following form. In general, effective December 18, 1986, non-financial (commercial) interests will not be allowed to acquire ownership positions in federally regulated trust, loan and insurance companies in excess of 10%, or to increase existing ownership positions where, as of December 18, 1986, they exceed 10%. However, there is a caveat in the case of trust, loan and insurance companies with less than $50 million in capital, and where the financial institution has difficulty accessing public capital markets. In other words, if a small firm is failing, the government may allow it to be taken over by a commercial interest.

Commercially linked financial holding companies will not be allowed to increase their holdings in subsidiary financial institutions even if the ownership test is met at the holding company level. However, they will be allowed to maintain their percentage ownership over time. This privilege will not be afforded to investors who acquire positions after December 18, 1986.

Trust, loan and insurance companies with capital in excess of $50 million, and which are "commercially linked", will have to have at least 35% of their voting shares widely-held and publicly traded by December 31, 1991, or within 5 years after reaching $50 million in capital. There is an added stipulation that the remaining 35% be widely-held and publicly traded. "Widely-held" means no shareholder owning more than 10% of the voting shares. "Publicly traded" means listed and traded on a recognized stock exchange in Canada.

Effective December 18, 1986, approval for the incorporation of new trust, loan and insurance companies will be restricted to applicants with no significant "commercial interests". For purposes of the ownership policy, a "commercial link" or "commercial interest" refers to corporations engaged in the production and distribution of goods and non-

financial services, or financial services on an unregulated basis. Examples of "unregulated financial institutions" are financial leasing companies and merchant banks.

Companies registered under the *Investment Companies Act* will generally be considered to be commercial entities. These companies include Power Financial Corporation and Trilon. However, the Department of Finance has indicated that some ICA companies will be considered to be non-commercial so long as they have no direct or downstream commercial interests.

Commercial activities which are permitted by law to be carried out by subsidiaries of financial institutions will not cause these financial institutions, or their parents, to be deemed to be linked to commercial companies for purposes of the ownership rules. The government is currently considering the possibility of making legal for all federal institutions any subsidiary business currently legal for any class of federal institution.

Individual investors, agents or representatives of individual investors and pension funds will not be considered to be commercial entities. However, this will not be the case where these entities have major commercial holdings as well as holdings in federally regulated financial institutions. A "commercial link" will be deemed to exist if a person holds more than 10% of any class, or series of any class, of the outstanding shares of a commercial company. This will be subject to a "de minimis" rule which will exempt persons where their total commercial interest, measured as the aggregate book value of all commercial ownership interests, is less than 5% of their total interest in regulated financial institutions, measured in a similar fashion.

In applying these rules, indirect links (e.g., through chains of holding companies) will be considered, although how this is to be monitored and controlled poses a serious problem. The interesting "commercial link" cases will relate to real estate holdings. This area should be the subject of early discussions with the Department of Finance by companies with real estate interests, and watched with great care once the legislation is tabled. A further difficult problem in this area is how the government plans to deal with domestic financial subsidiaries of foreign companies which happen to be commercially linked offshore; e.g., Sears and Allstate Insurance. This particular problem may prove to be the Achilles heel of the whole "commercial link" policy structure.

Ownership positions by commercial interests in federally regulated financial institutions which currently exceed 65% of any class, or any series of any class, of shares will have to be reduced to 65% by December 31, 1991.

<u>All</u> financial institutions with capital in excess of $750 million will be required to have at least 35% of their voting shares publicly traded and widely-held. Ownership positions held before December 18, 1986 will be "grandfathered" at the 65% level. However, where an ownership position subject to this requirement was established after December 18, 1986, the owner will not only have to reduce the holding to 65%, but no further shares can thereafter be acquired until the ownership position is ultimately diluted to 10%. In other words, the 10% ownership rule currently applicable to Schedule A banks will be applied to all ownership positions in federally regulated financial institutions established after December 18, 1986.

The definition of "capital" is not yet firmly established. However, it will correspond to "shareholders equity" on the financial statements. Look for changes to existing practices due to the differences which now exist between the definitions of capital for banks, trusts and insurance companies. The Department of Finance is committed to standardizing and rationalizing this definition.

No investor will be allowed to own more than 10% of any class, or any series of any class, of shares of any bank whose capital exceeded $750 million on December 18, 1986. Banks with capital less than $750 million may be closely-held, but only by non-commercial investors. After the date that a bank's capital reaches $750

million, shareholders with ownership positions in excess of 10% of any class of shares will not be allowed to increase their holdings of that class of shares. Shareholders with less than a 10% ownership position in any class of shares will only be allowed to increase their holdings to 10%. Within 5 years of the date on which the bank's capital reaches $750 million, at least 35% of the voting shares must be widely-held and publicly traded.

The bank ownership rules will apply to domestic ownership of Schedule A banks. Application of this rule to Schedule B foreign bank subsidiaries has not been announced in light of the ongoing trade negotiations with the United States, and the forthcoming multilateral discussions under GATT. However, officials indicate that should these negotiations result in the removal of all operating distinctions between foreign and Canadian banks, then the proposed ownership rules would be applied equally as well. Such a development would have serious implications for foreign banks in Canada.

A non-bank financial institution, with no commercial links, may acquire, or convert to, a bank if it gives the Minister of Finance the assurance that it will comply with the ownership policy for banks within an "acceptable time frame". According to the Department of Finance, the time frame deemed to be acceptable will be very short.

Finally, cumulative voting procedures will be mandatory for the election of directors of financial institutions where any single shareholder owns more than 10% of the voting shares.

## Regulatory Structure

The main thrust of the changes to the regulatory system is to ensure that the government has clear control over abuses of self-dealing and conflicts of interest. Related thrusts are to ensure that the regulatory system is made more efficient and effective through strengthening government and institutional self-regulatory mechanisms, and by improving the communication between government regulators, external auditors and institutional directors and management. The current rules will be made uniform for all financial institutions.

Measures will also be introduced to monitor and control transactions between "related" financial institutions. There will be stringent controls on "self-dealing". Most non-arm's length transactions involving transfers of assets will be banned. Non-arm's length transactions in services will be generally permitted provided no special terms or conditions are involved and are subject to controls including monitoring by independent members of the board of directors. Internal controls will be required to monitor permitted classes of transactions. A pre-clearance procedure will be introduced to enable institutions to obtain supervisory approval for "unusual" transactions.

Persons considered to be at non-arm's length to a financial institution will include:

- shareholders who beneficially own, directly or indirectly, 10% or more of any class, or series of any class, of shares (these are defined as "significant shareholders");
- directors and officers of the financial institution; auditors of the institution; directors and officers of corporations that beneficially own, directly or indirectly, 10% or more of any class, or series of any class, of shares of the financial institution;
- members of the immediate family of the above;
- the significant business interests of the financial institution or the persons mentioned above; and
- such other persons as the Superintendent may designate.

In general, loans to, investments in, and sales of assets to, or purchases of assets from, non-arm's length persons will be prohibited. Transactions between affiliated regulated

financial institutions will be treated less strictly subject to certain conditions. Transactions between a regulated financial institution and a wholly-owned subsidiary, all of whose liabilities are guaranteed by the parent, will be exempt.

Asset transactions will be permitted provided the assets acquired from related financial institutions do not exceed 20% of the capital of the institution, and that:

- in the case of securities, there is a well defined market and the transaction takes place at market prices;
- in the case of loans, the assets acquired may not be impaired in any way; and
- transactions involving low quality, or non-performing assets will not be allowed without express approval of the Superintendent.

Safeguards against abuses of conflicts of interest will be introduced, involving greater disclosure to consumers and shareholders. There will be barriers (Chinese Walls) to prevent the dissemination of inside information within an institution and enhanced internal scrutiny to ensure that these operate effectively.

Greater responsibilities and duties will be imposed on boards of directors and outside auditors. Use will be made of committees of independent directors to monitor potential self-dealing and conflict of interest situations, and to ensure appropriate flows of information to the external auditors and regulators. At least one-third of the directors on the board of a financial institution will have to be "independent" (a defined concept) of the institution.

Steps will be taken with the accounting profession to review and improve the accounting standards as they apply to financial institutions, especially with regard to the reporting of non-performing loans, loan losses, fees associated with loans, and "creative financing" techniques. Measures will also be introduced to ensure appropriate communication between auditors, financial institutions they audit and federal regulators.

## Supervisory System

Dramatic changes are in store for the supervisory system. Currently, each sector of the "four pillars" is supervised by a separate organization. Under the new regime, the federal supervisors will be consolidated under one Superintendent reporting to the Minister of Finance. Contrary to previous speculation, this new agency will not fall under the purview of the Minister of State (Finance). The main elements of the changes to the supervisory system include the following.

There will be a new Office of the Superintendent of Financial Institutions which will combine the roles of the current Inspector General of Banks and the Superintendent of Insurance. The new Superintendent will report to the Minister of Finance, and have clearer powers to deal with unsafe and unsound business practices, and with financially troubled institutions. There will be three Deputy Superintendents, one each for banks, non-bank deposit taking institutions, and insurance companies and pension funds.

An advisory committee of experts will be established to advise the Superintendent and to establish an "early warning system" which will allow the regulators to quickly identify troubled institutions. Procedures for dealing with financially troubled institutions will be standardized, including powers to assume control of an institution in emergency situations.

The Canada Deposit Insurance Corporation will remain a separate organization with private sector representation on its board. It will be given clearer powers in relation to the issuing and termination of insurance coverage. Deposit insurance premiums will be increased from current level of 1/10th of 1% of insured deposits to 1/6th of 1% in order to eliminate the current deficit in the insurance fund in a "timely way". The borrowing limit of the CDIC will also be increased from $1.5 billion to $3 billion.

## Other Related Matters

There are a range of related matters to be dealt with in the coming legislation. All federal financial institution legislation and regulations will be reviewed on a regular basis, roughly every ten years. The next scheduled review is 1996.

The deposit taking function of trust companies, which is now based on the guaranteed trust concept, will be replaced by the debtor/creditor concept in line with the practice in the *Bank Act* and the *Loan Companies Act*. The *Trust Companies Act* and the *Loan Companies Act* will be consolidated into one statute, as will the *Canadian and British Insurance Companies Act* and the *Foreign Insurance Companies Act*.

Regulated financial institutions will be restricted from issuing non-voting shares, and the corporate governance rules and procedures of the Canada Business Corporations Act will be incorporated into the trust, loan and insurance company statutes.

## Conclusions

The general thrust of the federal proposals have been well received by the financial services industry. However, as with all changes, there are areas which cause difficulty for specific institutions, especially those that are, or believe that they will be deemed to be, commercially linked. In addition, there are a number of proposals which are not as clearly defined and explained as one would like. For example, the areas dealing with "commercial interests", self-dealing and corporate governance. There are other areas where policy is still being formulated. All of these will hopefully be clarified prior to the introduction of legislation.

Overall the proposals have been judged to be superior to those which were released in the Green Paper in 1985, and have benefited substantially from all of the debate and discussion which occurred over the past two years. Many proposals incorporate the better recommendations of the House of Commons Finance Committee, the Senate Banking Committee and the Estey Commission. Furthermore, most of the proposals stand on their own merit and are reasonable responses to economic and international competitive realities. Unfortunately this cannot be said for the proposals dealing with the question of ownership. These can only be understood in terms of political considerations.

The net effect of these new ownership rules, coupled with the rules restricting commercial financial links, may be to turn the financial sector over to the large domestic banks and Canadian mutual life insurance companies. Smaller institutions, which do not have ready access to the capital markets, and who now cannot obtain infusions of capital from outside the financial sector, will be severely disadvantaged. One can expect mergers of smaller institutions to be required as was so typical in the banking area over the last twenty or thirty years.

Furthermore, ownership limits applicable to new entrants will all but ensure that few, if any, new institutions are formed. Consider the number of new banks that have been formed, and which have succeeded, since the 10% limit was imposed on bank ownership in 1967.

These policies will also make it even more difficult for Canadian firms to be truly world class. Most nations are now encouraging the re-allocation of capital between the commercial and financial sectors of their economies. The Canadian government is now proposing to preclude this possibility in Canada. Without much expanded capital bases, it is hard to see many Canadian institutions facing up to the competitive challenges posed by the large foreign institutions, especially the Japanese.

Another concern is that by restricting ownership and outside investment, Canada is turning the system over to management controlled firms, and worse still, putting this management outside the reach of shareholder control. History has shown that firms released from such discipline have not typically been the

most competitive or innovative. At a time when the financial services sector is undergoing monumental world-wide change, this can hardly be the time to eliminate the entrepreneurial element from the Canadian industry.

With regard to the timing of legislation, we can expect to see the regulatory and supervisory package by the end of February. The package, including what is now Bills C-8 and C-9, plus the authorization for federal firms to own securities dealers will follow in three to four weeks. Finally, the package dealing with powers and ownership will be released in draft form sometime in June. According to Finance officials, the "rock bottom line" is to have all of the material tabled in the House prior to the summer recess of Parliament, although it is hoped that the first two elements can be passed into law before the House rises.

If Finance is able to meet this timetable, then one can expect Committee sessions on the legislation dealing with ownership and powers in the fall. Passage of this legislation would then be possible before the end of 1987, hopefully with the counter-productive sections dealing with ownership removed.

## DEREGULATION OF DOMESTIC NATURAL GAS MARKETS - AN ONTARIO PERSPECTIVE

By: William T. Houston
Fraser & Beatty, Ottawa

### Background to Deregulation

Until recent changes in the regulation of natural gas transmission and marketing in Canada, there was essentially no free market for the acquisition, transportation or sale of natural gas moving in inter-provincial trade in Canada.

All western natural gas for sale in Ontario was purchased by a monopoly buyer, TransCanada PipeLines Limited (TCPL). Industries wishing to buy gas and producers wishing to sell gas directly to those industries were frustrated by the entrenched system of total regulation.

From the passage of the *Petroleum Administration Act (P.A.A)* in 1975 until 1985, the price of gas at its point of delivery into the western terminus of the TCPL system near Empress, Alberta was set by agreement between the Government of Alberta and the Government of Canada.

The gas was then moved by the only means of transporting it to markets in Saskatchewan, Manitoba, Ontario and Quebec, that is the TCPL pipeline system, whose tolls for service were in turn regulated and set by the National Energy Board.

TCPL in turn resold the gas brought east to the various Ontario franchised distribution companies: Union Gas Limited, The Consumers Gas Company Ltd. and Northern and Central Gas Corporation (now I.C.G. Utilities (Ontario) Ltd.)

The price of the gas at the point of resale to the distributors was further regulated by the setting of 'city gate' prices under the *P.A.A.*

In the now bygone world of ever rising oil prices, the price of natural gas (of which Canada had a surplus) was set artifically below that of oil (much of which was imported) on a heating value equivalent basis. This was, during the early 1980's, all part of the grand design of the National Energy Program (1980) and its various updates, which had as a main thrust the promotion of natural gas at the expense of oil. Natural gas is described by its sellers as a premium fuel for several reasons - namely, its cleanliness and ease of delivery in comparison to oil. Natural gas was priced significantly below its commodity value in terms of oil. For example, 1,000 British Thermal Units (BTU) of

energy from natural gas was priced at approximately two-thirds of the price of oil at a given location. Thus, a price advantage was maintained through to the burner tip in home or industry.

Under the Canada/Alberta Agreement of September, 1981, the Alberta border price was set at $2.57 per thousand cubic feet (mcf). That agreement foresaw regulated prices increasing at six month intervals on a steady basis for a five year period.

## The New Regime

This "neat" system with "end to end" regulated natural gas pricing underwent a major change in late 1985, when, following the signing of the "Western Accord" in March of that year, the Government of Canada entered into an agreement with the governments of the three western producing provinces with respect to the marketing of natural gas. The resulting document, the "Agreement on Natural Gas " (the Agreement) provided that, as of November 1, 1986, the price of all natural gas moving in inter-provincial trade would be determined by negotiations between buyers and sellers. The Agreement also provided for a phase-in period of partial deregulation in the preceding year.

As federal regulation ends at the point of delivery of gas from TCPL to the various provincially regulated distributors, cooperation of the provincial regulatory authorities to implement deregulation was necessary. The Ontario Energy Board has shown that it is anxious to cooperate.

The real meaning of the Agreement at present is that larger industrial and commercial users of natural gas in the consuming provinces may contract with (primarily Alberta) producers for the acquisition of gas at a free market price. Smaller industrial and commercial customers and residential customers are not able to participate in the direct purchase market although this may change as a brokerage function develops to put together buying groups and to supply market information and expertise which it is not economic for a single smaller user to acquire.

The direct purchaser of gas has the option of making its own transportation arrangements for delivery of the gas with TransCanada PipeLines Limited and the local distributor or alternatively contracting with the distributor for the sale of gas either: a) simultaneously at the point of acquisition at the Alberta/Saskatchewan border or b) at the point of delivery of the gas from TCPL at the point of inter-connection of TCPL and the distributor. This later arrangement (known as a "Buy/Sell" transaction) while conceptually more complicated is administratively more simple.

In accordance with the preliminary decision of the Ontario Energy Board with regard to the Contract Carriage of Natural Gas (E.B.R.O. 410-411-412) and the final decision released March 23, 1987, the Ontario distributors are authorized to enter into Buy/Sell Transactions which provide for the re-purchase of the natural gas, acquired at, the free market price, at the distributors alternative cost of acquisition from TCPL (or Western Gas Marketing Limited, its newly created marketing arm). The price differential between the free market acquisition cost and the re-sale at the regulated equivalent price can provide a wedge of in excess of $1.10 per mcf (3.0¢ per cubic metre) depending on the contract volume. Gas consumers entering into Buy/Sell or other direct purchase arrangements lose eligibility for industrial user discounts administered by the local distribution companies. However, these discounts are generally much lower than the savings available from the opportunity now provided to purchase gas directly from gas producers.

To date, approximately 80 large industrial and commercial users of natural gas have entered into direct purchase arrangements providing for either transportation to their plant gate or delivery for resale under a Buy/Sell agreement. The direct purchase market is not yet vigorous as there is a significant lack of information in the market place among potential direct purchasers and remaining elements of uncertainty with respect to the

regulatory policy of the Province of Alberta. The Province of Alberta has conditioned the permits required to remove gas from the province to provide that they may be cancelled in the event that the Government of Alberta does not find satisfactory the forthcoming decision of the National Energy Board with respect to the surplus test to be applied to exports to the United States.

The province of Alberta which is supplying the overwhelming majority of the gas involved in direct purchase arrangements, while a signatory to the agreement, retains the right to grant removal permits for any gas to be moved outside the province. In effect, the discretion is retained to refuse removal permits where the Government of Alberta, through the Alberta Energy Resources Conservation Board, concludes that the direct sale price is "too low". In order for the market to develop vigorously as a free market for natural gas, there will need to be assurances, at least for the medium term, that removal permit applications which meet other normal criteria will not be denied or delayed by reason of the proposed sale price. The province would of course retain special jurisdiction with respect to non-arm's length sales, this point being specifically provided for in the Agreement.

## The Future

As of the time of writing in late March 1987, the deregulation of natural gas markets foreseen in the Western Accord and subsequent regulatory pronouncements is only beginning to function.

The pipelines as transporters of gas and as natural monopolies continue and will continue to remain regulated and will continue to be permitted to earn their regulated rates of return.

Notwithstanding the fact that the regulatory system did not provide for the earning of profits on the marketing function both TCPL and the local distriibution companies have been reluctant to surrender that function. The preeminent positions of TCPL in the gas purchasing market and of the local distribution companies in the gas sales market have been reinforced by the lack of market information particularly on the part of potential direct purchasers.

In the absence of informed direct purchasers willing to contract to acquire gas at free market prices there cannot develop a vigorous market of gas producers/sellers. The growth in the role of brokers (which has been encouraged by the March 23, 1987 O.E.B. decision), both those who are oriented to producers as marketers of gas, and those who are oriented to consumers as shoppers for gas, should facilitate the development of a truly free market for the acquisition and sale of natural gas.

The establishment of competition in the domestic natural gas market should also, as a corollory, increase the competitiveness of Canadian industry with benefits to owners, workers and consumers.

## NOTIFIABLE TRANSACTION REGULATIONS

*The following is the text of proposed regulations respecting Notifiable Transactions, their statutory notice, and the supporting Regulatory Impact Assessment Statement as published in the* Canada Gazette, *Part I on March 14, 1987. All proposed regulations under the* Competition Act *must be published at least 60 days before the proposed effective date and a reasonble opportunity must be given to interested persons to make representations. Federal government policy also now requires a Regulatory Impact Assessment Statement (describing the purposes and impact of the proposal) to be published with draft regulations to assist in the preparation of representations.*

### Statutory Authority
### *Competition Act*, s. 81, 82, and 96

### Regulatory Impact Analysis Statement

#### Description

The *Competition Act* requires that merger transactions above certain thresholds be notified before they are completed. The intent of the

regulations is to enable business persons to determine readily whether they meet these thresholds. The regulations specify the method of, and the time or annual period for, calculation of aggregate value of assets and gross revenue from sales for the purpose of the various thresholds (party size limit, asset limit, share limit, amalgamation limit, combination limit). Neither the law nor the regulations contain a sunset clause. A more detailed description of the content of the regulations is available on request.

### Alternatives Considered

No viable alternative exists to the proposed regulations. Relying on consensus standards for the calculation of assets and revenues from sales is not feasible given the complexity of the various forms of transactions that could trigger the prenotification requirements. The absence of these regulations would have created uncertainty in the law and would have reduced its effectiveness.

### Consistency with Regulatory Policy and Citizens' Code

The proposed regulations are of a facilitative nature and do not conflict with any of the listed elements of the Citizens' Code. Fairness is a key element in the proposed regulation since they make use of information readily available so as to avoid imposing a burden on business.

### Anticipated Impact

The proposed regulations minimize business compliance costs by relying on definitions based on standard accounting practices and by making use of information readily available.

Implementation costs incurred by the Government are also minimized since the regulations clearly identify when a particular transaction becomes notifiable.

The regulations rely on information used by business persons on a regular basis and would therefore minimize paper burden.

### Consultation

There has been no public consultation in the development of the regulations. However, the regulations were developed with the assistance of experts in accounting and securities law retained for this purpose.

### Compliance Mechanism

The failure to comply with the prenotification provisions of the *Competition Act* is subject to criminal law sanctions. There is no offence created by the regulations themselves. The clarification provided by the regulations makes it easier to comply and avoid entering into conflict with the law. The Government will monitor the compliance to the prenotification provisions of the *Competition Act* through publicly available information.

For further information Contact: Gilles Ménard, Co-ordinator, Legislation Implementation Secretariat, 997-4250.

## Proposed Regulatory Text

Notice is hereby given, pursuant to subsection 96(2)* of the *Competition Act***, that the Governor in Council, persuant to sections 81, 82 and subsection 96(1) of that *Act*, proposes to make regulations respecting notifiable transactions pursuant to Part VIII of the *Competition Act.*

The proposed effective date of the regulations is the coming into force of Part III of the *Act.*

Any interested person may make representations concerning the proposed regulations within 60 days after the publication of this notice to the Minister of Consumer and Corporate Affairs, Place du Portage, Tower I,

Hull, Quebec. All such representations must cite *Canada Gazette,* Part I and the date of publication of this notice. Their representations should also stipulate those parts of the representation that should not be disclosed pursuant to the *Access to Information Act,* in particular pursuant to sections 19 and 20 of that *Act,* the reason why those parts should not be disclosed and the period that those parts should remain undisclosed. The representations should also stipulate those parts of the representation for which there is consent to disclosure pursuant to the *Access to Information Act.*

## Regulations Respecting Notifiable Transactions Pursuant to Part VIII of the *Competition Act.*

### Short Title

1. These Regulations may be cited as the Notifiable Transactions Regulations.

### Interpretation

2. In these Regulations, "Act" means the *Competition Act;* (Loi) "audited financial statements" means financial statements in respect of which a report has been prepared by external professional auidtors who are accredited for that purpose; (états finanaciers vérifiés) "reference date" means

   (a) where the Director is notified pursuant to section 86 of the *Act* of a proposed transaction, the date on which the Director receives the notification, and

   (b) where the notification referred to in paragraph (a) is not given to the Director,

      (i) in the case of a proposed transaction referred to in subsection 82(4) of the *Act,* the 30th day preceding the day on which articles of amalgamation in respect of the proposed transaction are filed with the appropriate governmental or regulatory authority, and

      (ii) in the case of a proposed transaction referred to in subsection 82(2), (3) or (5) of the *Act,* the 30th day preceding the day on which beneficial ownership of property forming any part of the subject-matter of the transaction is to be conveyed, assigned or otherwise transferred. (date de l'avais)

### Audited Financial Statements

3. Audited financial statements shall

   (a) be prepared in accordance with accounting principles that are normally used by the person with respect to whom the statements were prepared and that are generally accepted for the type of business carried on by the person; and

   (b) include working papers and other records used to prepare audited financial statements if reference to the working papers and other records is necessary to obtain information required for making a determination, pursuant to sections 81 and 82 of the *Act,* of the aggregate value of assets or the gross revenues from sales.

### Determination of Aggregate Value - General

4.(1)For the purposes of Sections 81 and 82 of the *Act,* in determining the aggregate value of assets, the following amounts shall be deducted:

   (a) any amount that represents duplication arising from transactions between affiliates;

   (b) any amount that represents duplication arising from an ownership interest of one person in another person, whether or not those persons are affiliated; and

(c) any amount provided for depreciation or diminution of value.

(2) For the purposes of sections 81 and 82 of the *Act*, in determining the aggregate value of assets, no amount shall be deducted for liabilities or encumbrances.

(3) The aggregate value of assets shall be expressed in Canadian dollars.

5.(1) Subject to subsection (2), for the purposes of sections 81 and 82 of the *Act*, the gross revenues from sales of a person for an annual period shall be determined by aggregating the following amounts accruing to that person during that period without deducting any expenses or amounts incurred or provided for:

(a) amounts accruing from the sale or lease of goods, other than amounts that are not properly included in revenue in accordance with the accounting principles referred to in paragraph 3(a);

(b) amounts accruing from the rendering of services.

(2) In determing the gross revenues from sales, any amount that represents duplication arising from transactions between affiliates shall be deducted.

(3) Gross revenues from sales shall be expressed in Canadian dollars.

6. Subject to section 12, for the purposes of sections 81 and 82 of the *Act*, the aggregate value of assets of a person shall be determined as of the last day of the period covered by the most recent audited financial statements in which those assets are accounted for, where that date is not more than 15 months prior to the reference date.

7. Subject to section 13, for the purposes of sections 81 and 82 of the *Act*, gross revenues from sales of a person shall be determined for the annual period ended on the last day, which day is not more than 15 months prior to the reference date, of the period

(a) covered by the most recent audited financial statements in which those gross revenues are accounted for, and

(b) in the case where the period covered by the financial statements referred to in paragraph (a) is less than 12 months, covered by those financial statements and by audited financial statements in which the gross revenues are accounted for, covering the balance of the 12-month period.

## Provisions with Respect to Parties to the Transaction

8.(1) For the purposes of paragraph 81(1)(a) of the *Act*, the aggregate value of assets in Canada of the parties to a transaction, together with their affiliates, shall be determined by aggregating the aggregate values of the assets in Canada of each of the parties and each affiliate.

(2) For each party or affiliate referred to in subsection (1), the aggregate value of its assets in Canada shall equal the aggregate amount of those assets as stated in the audited financial statements referred to in section 6.

9.(1) For the purposes of paragraph 81(1)(b) of the *Act*, gross revenues from sales in, from or into Canada of the parties to a transaction, together with their affiliates, shall be determined by aggregating the gross revenues from sales in, from or into Canada of each of the parties and each affiliate.

(2) For each party or affiliate referred to in subsection (1), the gross revenues from sales in, from or into Canada shall equal the aggregate amount of those gross revenues as stated in the audited financial statements referred to in section 7.

### Provisions Applicable to Transactions

10. For the purposes of subsections 82(2) to (5) of the *Act*, the aggregate value of assets in Canada

(a) of an operating business referred to in subsection 82(2) of the *Act*,

(b) that are owned by a corporation referred to in paragraph 82(3)(a) of the *Act*,

(c) that would be owned by any corporation referred to in paragraph 82(4)(a) of the Act, or

(d) that are the subject-matter of a combination referred to in subsection 82(5) of the *Act*

shall equal the aggregate amount of the assets described in paragraphs (a), (b), (c) or (d), as applicable, as stated in the audited financial statements referred to in section 6.

11. For the purposes of subsections 82(2) to (5) of the *Act*, the gross revenues from sales in or from Canada generated from the assets in Canada

(a) of an operating business referred to in subsection 82(2) of the *Act*,

(b) that are owned by any corporation referred to in paragraph 82(3)(a) of the *Act*,

(c) that would be owned by any corporation referred to in paragraph 82(4)(a) of the *Act*, or

(d) that are the subject-matter of a combination referred to in subsection 82(5) of the *Act*

shall equal the aggregate amount of the gross revenues described in paragraphs (a), (b), (c) or (d), as applicable, as stated in the audited financial statements referred to in section 7.

### Determination of Aggregate Value - Specific Circumstances

12.(1)Where the aggregate value of assets of a person cannot reasonably be determined in accordance with subsection 8(2) or section 10, the aggregate value of the assets

(a) shall equal the aggregate amount of the assets as stated in the books of the person with such adjustment as may be necessary to ensure that the determination is in accordance with the accounting principles referred to in paragraph 3(a); and

(b) shall be determined as of the most recent date that the amount can reasonably be determined, provided that that date is within the three months prior to the reference date.

(2) The determination of the aggregate value of assets referred to in subsection (1) is subject to the requirements of section 4.

13.(1)Where gross revenues from sales of a person cannot reasonable be determined in accordance with subsection 9(2) or section 11, the gross revenues

(a) shall equal the amount of the gross revenues as stated in the books of the person with such adjustments as may be necessary to ensure that the determination is in accordance with the accounting principles referred to in paragraph 3(a); and

(b) shall be determined for the most recent annual period that the amount can reasonably be determined provided that the last day of that period is within the three months prior to the reference date.

(2) The determination of the gross revenues from sales referred to in subsection (1) is subject to the requirements of section 5.

14.(1)If, subsequent to the day or date referred to in section 6 or 12 or the annual period referred to in section 7 or 13, as the case

may be, any party to a proposed transaction or any affiliate of that party was a party to or was otherwise affected by a transaction or event the consequences of which, if taken into account, would affect the determination of whether notification is required to be given under section 86 of the *Act* with respect to the proposed transaction, the values referred to in sections 8 to 13 shall be adjusted to reflect that transaction or event.

(2) A transaction or event referred to in subsection (1) includes any of the following:

(a) a write-down or re-evaluation for financial reporting purposes of the value of any assets of the parties to the proposed transaction or their affiliates;

(b) any disposition, acquisition or reorganization that is likely to have a material effect on the aggregate value of the assets of the parties to the proposed transaction or any of their affiliates; and

(c) any agreement, arrangement, understanding or other transaction or event that is likely to have a material effect on the aggregate value of the assets or gross revenues from sales of the parties to the proposed transaction or their affiliates.